

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:04

PLR-122915-13

Date:

January 09, 2014

Re:

### Legend

Decedent	=
Date 1	=
Spouse	=
Child 1	=
Child 2	=
Child 3	=
Child 4	=
Child 5	=
Child 6	=
Grandchild 1	=
Grandchild 2	=
Date 2	=
Date 3	=
Date 4	=
Trust	=
Date 5	=
Court	=
Year 1	=
<u>x</u>	=
<u>a</u>	=
<u>b</u>	=
<u>c</u>	=
<u>y</u>	=
<u>d</u>	=
<u>e</u>	=
State	=
Statute	=

Judgment =

Order =

Date 6 =

Date 7 =

Bank =

Year 2 =

Date 8 =

Dear :

This letter responds to your authorized representative's letter, dated May 10, 2013, in which you request rulings concerning the generation-skipping transfer (GST) tax consequences regarding the above-referenced Trust.

#### FACTS

The facts submitted and representations made are as follows:

Decedent died testate on Date 1, survived by Spouse, six children (Child 1, Child 2, Child 3, Child 4, Child 5, and Child 6) and two grandchildren (Grandchild 1 and Grandchild 2). Child 6 predeceased Spouse on Date 2, and was survived by her children, Grandchild 1 and Grandchild 2. Spouse died on Date 3. Child 1 and Child 2 are Decedent's children from a prior marriage.

Section III of Decedent's will, dated Date 4, provides for the creation of a trust for the benefit of Spouse (Marital Trust).

Section IV of Decedent's will provides that the rest and residue of the estate passes to Trust. The trustee of Trust may distribute net income to Spouse, when added to income available to her from other sources, to provide for her health, support and maintenance in accordance with her station in life. Any net income not distributed to Spouse may be distributed to Decedent's children or descendants for their health, education, maintenance and support. Distributions of corpus may be made if the net income distributed to a beneficiary, together with other income from other sources, is not adequate for the proper and appropriate education, health, maintenance and support of any beneficiary of the trust to whom income is distributable. No corpus distributions are to be made to Spouse until Marital Trust is entirely exhausted. Upon the death of Spouse, Trust shall terminate and all the trust assets are to be distributed free of trust to Decedent's children and the descendants of any deceased child, *per stirpes*.

Decedent's Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, was timely filed. It is represented that Trust has an inclusion ratio of zero for purposes of chapter 13 of the Code.

On Date 5, Child 1, a child of Decedent from his first marriage, petitioned Court seeking, among other things, the removal of Spouse as trustee of Marital Trust and Trust, as well as monetary damages for alleged breach of fiduciary duties by Spouse as trustee, and other relief.

Approximately two years later, Spouse and Decedent's children and grandchildren (collectively Decedent's Descendants) entered into Year 1 Family Settlement Agreement wherein they agreed to a reformation of Trust to include, among other items, the following:

The successor trustee will be a corporate trustee.

Section IV of Decedent's will is to be modified to make mandatory distributions of net income, as follows: If net income exceeds \$x in a year, then a percent of net income will be distributed to Spouse; b percent of net income will be distributed to each of Child 1, Child 2, Child 3, Child 4, and Child 5; and c percent of net income will be distributed to each of Grandchild 1 and Grandchild 2. If net income is more than \$y but less than \$x in a year, then \$y will be distributed to Spouse; d percent of net income will be distributed to each of Child 1, Child 2, Child 3, Child 4, and Child 5; and e percent of net income will be distributed to each of Grandchild 1 and Grandchild 2. If net income is less than \$y in a year, then all net income will be distributed to Spouse. No corpus distributions will be made to any beneficiary.

Section V of Decedent's will is to be modified to provide that no provision for depletion is to be made in determining or calculating net income from trust accounting purposes which will result in the amount of fiduciary net income distributable to any income beneficiary being increased.

The termination provisions of Trust upon Spouse's death will remain unchanged.

Trust is governed by the laws of State. Statute provides, in part, that a court may order that the trustee be changed or that the terms of the trust be modified if the order is necessary or appropriate to achieve the settlor's tax objectives and is not contrary to the settlor's intentions.

After two more years passed, on Date 6 and Date 7, Court entered Judgment and Order, respectively, modifying Decedent's will and the trusts created therein, as set forth in the Year 1 Family Settlement Agreement. Court also removed Spouse as trustee of Marital Trust and Trust, and replaced Spouse with Bank. The modifications of

Trust pursuant to the Judgment will not be effective until the issuance of a favorable private letter ruling by the Internal Revenue Service.

Spouse subsequently died on Date 3. After Spouse's death, Decedent's estate, Trust, and Decedent's Descendants entered into Year 2 Family Settlement Agreement, dated Date 8. The Year 2 Family Settlement Agreement provided, among other things, that after the payment of all expenses, compensation of the trustee and attorneys fees incurred by the trustee, all of the accumulated income and corpus of Trust would be distributed outright, pursuant to Section IV of Decedent's will, as follows: d percent to each of Child 1, Child 2, Child 3, Child 4, and Child 5; and e percent to each of Grandchild 1 and Grandchild 2.

From December, Year 1, until Spouse's death on Date 3, distributions from Trust were made according to the Year 1 Family Settlement Agreement, as approved by Court in the Judgment and Order.

You request the following rulings:

1. Trust has an inclusion ratio, as defined by § 2642(a), of zero.
2. None of the terms or provisions of the Judgment will cause Trust to have an inclusion ratio, as defined by § 2642(a), greater than zero.
3. None of the terms or provisions of the Year 2 Family Settlement Agreement will cause Trust to have an inclusion ratio, as defined by § 2642(a), greater than zero.
4. No GST tax was or is due upon any taxable distributions or taxable termination made or to be made from Trust to any of Decedent's Descendants since Trust has an inclusion ratio of zero, as defined by § 2642(a).

#### LAW AND ANALYSIS

Section 2601 imposes a tax on every generation-skipping transfer made after October 22, 1986. Section 2611(a) provides that the term "generation-skipping transfer" means a taxable distribution, a taxable termination, and a direct skip.

Section 2602 provides that the amount of tax imposed by § 2601 is the taxable amount, multiplied by the applicable rate. Section 2641(a) provides that, for purposes of chapter 13, the term "applicable rate" means, with respect to any generation-skipping transfer, the product of the maximum federal estate tax rate, and the inclusion ratio with respect to the transfer.

Section 2642(a)(1)(A) provides, in relevant part, that, for purposes of chapter 13, the inclusion ratio with respect to any property transferred in a generation-skipping

transfer shall be the excess (if any) of 1 over the applicable fraction determined for the trust from which such transfer is made. Section 2642(a)(2) provides, in relevant part, that the applicable fraction is a fraction the numerator of which is the amount of the GST exemption allocated to the trust and the denominator of which is the value of the property transferred to the trust, reduced by the sum of any federal estate tax, or state death tax actually recovered from the trust attributable to such property, and any charitable deduction allowed under §§ 2055 or 2522 with respect to such property.

Section 2631 provides, for the year in issue, that for purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption of \$1,000,000 which may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor.

Section 26.2601-1(b)(4)(i) of the Generation-Skipping Transfer Tax Regulations, provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the GST tax under § 26.2601-1(b)(1), (2), or (3) will not cause the trust to lose its exempt status. The rules contained in § 26.2601-1(b)(4)(i) are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. Unless specifically providing otherwise, the rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purpose of § 1001.

Section 26.2601-1(b)(4)(i)(B) provides that a court-approved settlement of a bona fide issue regarding the administration of the trust or the construction of terms of the governing instrument will not cause an exempt trust to be subject to chapter 13, if (1) the settlement is the product of arm's length negotiations; and (2) the settlement is within the range of reasonable outcomes under the governing instrument and applicable state law addressing the issues resolved by the settlement. A settlement that results in a compromise between the positions of the litigating parties and reflects the parties' assessments of the relative strengths of their positions is a settlement that is within the range of reasonable outcomes.

Section 26.2601-1(b)(4)(i)(D)(1) provides that a modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy § 26.2601-1(b)(4)(i)(A), (B), or (C)) by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the provisions of chapter 13, if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

It is represented that Decedent's estate allocated sufficient GST exemption to Trust to cause Trust to have an inclusion ratio of zero under § 2642. No guidance has been issued concerning a modification that may affect the status of a trust that is exempt from GST tax because sufficient GST exemption was allocated to the trust to result in an inclusion ratio of zero. At a minimum, a modification that would not affect the GST status of a "grandfathered trust" should similarly not affect the exempt status of such a trust.

In this case, it is evident from the facts and representations that negotiations and litigation continued over a period of several years. The Judgment and Order resolved issues regarding, among other matters, the identity of the proper trustee and the distributions of net income from Trust. The Judgment and Order constitutes a settlement of bona fide issues regarding the administration of Trust and the distribution of trust assets. We conclude that the Judgment and Order was the product of arm's length negotiations and represents a compromise that reflects the parties' assessments of the relative strengths of the positions of the various parties, and is within the range of reasonable outcomes under the governing instrument and the applicable state law.

After Spouse's death, the Year 2 Family Settlement Agreement memorialized the terminating distributions of Trust, pursuant to the original terms of Trust. We conclude that the Year 2 Family Settlement Agreement does not shift a beneficial interest in Trust to any beneficiary who occupies a lower generation than the person or persons who held the beneficial interest prior to the agreement or extend the time for vesting of any beneficial interest in Trust beyond the period provided in Trust.

Accordingly, based on the facts and representations, we rule as follows:

1. Trust has an inclusion ratio, as defined by § 2642(a), of zero.
2. None of the terms or provisions of the Judgment will cause Trust to have an inclusion ratio, as defined by § 2642(a), greater than zero.
3. None of the terms or provisions of the Year 2 Family Settlement Agreement will cause Trust to have an inclusion ratio, as defined by § 2642(a), greater than zero.
4. No GST tax was or is due upon any taxable distributions or taxable termination made or to be made from Trust to any of Decedent's Descendants since Trust has an inclusion ratio of zero, as defined by § 2642(a).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

James F. Hogan  
Chief, Branch 4  
Office of Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)

cc: